ST 01-0133-GIL 07/26/2001 CONSTRUCTION CONTRACTORS

Under Illinois law, a person who takes tangible personal property off the market and converts it into real estate is deemed a construction contractor and is the legal end-user of the tangible personal property. See 86 Ill. Adm. Code 130.1940 and 130.2075. (This is a GIL).

July 26, 2001

Dear Xxxxx:

This letter is in response to your letter dated April 2, 2001. The nature of your letter and the information you have provided require that we respond with a General Information Letter, which is designed to provide general information, is not a statement of Department policy and is not binding on the Department. See 2 Ill. Adm. Code 1200.120(b) and (c), which can be found on the Department's website at http://www.revenue.state.il.us/legalinformation/regs/part1200.

In your letter, you have stated and made inquiry as follows:

AAA is a STATE electric sign manufacturer that files a monthly Illinois Sales and Use Tax Return. While I have read information on your web site and occasionally called for advice on handling particular tax questions, I would like to review the various situations we face in our business in regards to taxation issues.

We have no facilities in Illinois, but our employees periodically go into Illinois to install or service signage. While it is rare, we may occasionally have a salesperson visit a customer in your state.

Normally we manufacturer, install and service the signs we make. However, we sometimes hire a subcontractor to do the install or servicing. Occasionally, we sell the signs we make to other parties who resell the sign to their Illinois customer. Sometimes these resellers do the install themselves.

What approach do we take to determine our proper sales or use tax obligation?

Some questions that come to mind:

1) Are we considered a retailer or an end-user contractor or does it depend on the particular product and/or situation?

2) Do you see any situation where we would need to charge sales tax on the amount of the sale rather than pay use tax on material used to make the product?

a) If we have to collect sales tax, is it charged on both labor and material?

3) Does it make any difference whether the sign is real or personal property?

   a) If so, what sort of signage would be defined as real property? Would a sign mounted on a pole cemented into the ground be considered part of real property?

4) Does it make any difference if we install the sign ourselves or hire someone else to do it for us?

5) If we manufacture and sell the sign to a reseller, are we liable for use tax on the materials that go into the sign even if the reseller charges sales tax to the end user?

6) If we are paying use tax on materials used to manufacture a sign, is tax due on:

   a) Freight charges we pay to have suppliers ship component materials to us?

   b) Freight charges we incur in having the finished signage shipped to the destination in Illinois?

   c) Packaging materials used to protect the sign while it is being transported to Illinois?

   d) Permits we have to acquire to put up the signs in Illinois?

   e) The costs to hire Illinois subcontractors to install or help us install the sign?

   f) The costs of renting equipment (example: scissors lift) in Illinois to assist us in installing the sign?

7) What if we sell the sign to a leasing company in Iowa that leases the sign to our Illinois customer?

8) Do we just pay use tax on any materials used if we send employees into Illinois to service an existing sign? Does it make any difference if we instead hire a sign company in Illinois to service the sign for our Illinois customer?

The advice we have received in the past seemed to indicate we should pay use tax on the material that we consume in producing the signage, but it was not clear if that covered every situation referenced above.

Please call if you need more information.

A person who sells signs that have commercial value (i. e., value to persons other than the purchasers) incurs Retailers' Occupation Tax (sales tax) liability when making such sales, even if such signs are produced on special order for the purchaser. Examples of signs having such commercial value would be ones that spell out "real estate", "insurance," or "hamburgers," and which do not spell out the name of the purchaser nor the brand name of the purchaser's product and which

are not otherwise similarly individualized. Please refer to 86 Ill. Adm. Code 130.2155 Vendors of Signs, enclosed. When a sign that has commercial value is sold and installed, the installation charge is also subject to Retailers' Occupation Tax unless there is a separate agreement for the installation charge. See 86 Ill. Adm. Code 130.450, enclosed.

If the sign vendor produces a sign on special order of the customer and the sign is so specialized that it would have no commercial value to anyone other than that particular customer who placed the order, the sign vendor would not incur Retailers' Occupation Tax liability. These transactions would be subject to liability under the Service Occupation Tax Act and the sign vendor would be considered a serviceman.

The above assumes that the signs remain tangible personal property after installation. If the signs were permanently affixed structurally as real estate, then there would be different tax consequences. Under Illinois law, a person who takes tangible personal property off the market and converts it into real estate is deemed a construction contractor and is the legal end-user of the tangible personal property. The construction contractor, as the user, incurs Illinois Use Tax and local Retailers' Occupation Tax reimbursement liabilities when the tangible personal property that will be converted into real estate is purchased from registered Illinois suppliers. If such items were purchased from suppliers that did not collect the tax, the person who converts the tangible personal property into real estate is required to self-assess and remit the Use Tax to the Department based upon the cost price of the property. For information on construction contractors, see 86 Ill. Adm. Code 130.1940 and 130.2075, enclosed.

Your letter indicates that you lease equipment for use in installing your signs in Illinois. Please note that the State of Illinois taxes leases differently for Retailers' Occupation Tax and Use Tax purposes than the majority of other states. For Illinois sales tax purposes, there are two types of leasing situations: conditional sales and true leases.

A conditional sale is usually characterized by a nominal or one dollar purchase option at the close of the lease term. Stated otherwise, if lessors are guaranteed at the time of the lease that the leased property will be sold, this transaction is considered to be a conditional sale at the outset of the transaction, thus making all receipts subject to Retailers' Occupation Tax.

A true lease generally has no buy out provision at the close of the lease. If a buy out provision does exist, it must be a fair market value buy out option in order to maintain the character of the true lease. Lessors of tangible personal property under true leases in Illinois are deemed end users of the property to be leased. See the enclosed copy of 86 Ill. Adm. Code 130.220. As end users of tangible personal property located in Illinois, lessors owe Use Tax on their cost price of such property. The State of Illinois imposes no tax on rental receipts. Consequently, lessees incur no tax liability.

The above guidelines are applicable to all true leases of tangible personal property in Illinois except for automobiles leased under terms of one year or less, which are subject to the Automobile Renting Occupation and Use Tax found at 35 ILCS 155/1 et seq.

As stated above, in the case of a true lease, the lessors of the property being used in Illinois would be the parties with Use Tax obligations. The lessors would either pay their suppliers, if their suppliers were registered to collect Use Tax, or would self-assess and remit the tax to the Department. If the lessors already paid taxes in another state with respect to the acquisition of the tangible personal property, they would be exempt from Use Tax to the extent of the amount of such tax properly due and paid in such other state. See 86 Ill. Adm. Code 150.310(a)(3) enclosed.

Under Illinois law, lessors may not “pass through” their tax obligation on to the lessees as taxes. However, lessors and lessees may make private contractual arrangements for a reimbursement of the tax to be paid by the lessees. If lessors and lessees have made private agreements where lessees agree to reimburse lessors for the amount of the tax paid, then lessees are obligated to fulfill the terms of the private contractual agreements.

In regards to your questions concerning freight, as a technical proposition, handling charges represent a retailer’s cost of doing business, and are consequently always included in gross charges subject to tax. See, 86 Ill. Adm. Code 130.410. However, such charges are often stated in combination with shipping charges. In this case, charges designated as “shipping and handling,” as well as delivery or transportation charges in general, are not taxable if it can be shown that they are both separately contracted for and that such charges are actually reflective of the costs of shipping. To the extent that shipping and handling charges exceed the costs of shipping, the charges are subject to tax. As indicated above, charges termed “delivery” or “transportation” charges follow the same principle.

The best evidence that shipping and handling or delivery charges have been contracted for separately by purchasers and retailers are separate contracts for shipping and handling or delivery. However, documentation that demonstrates that purchasers had the option of taking delivery of the property, at the sellers’ location for the agreed purchase price, plus an ascertained or ascertainable delivery charge, will suffice. If retailers charge customers shipping and handling or delivery charges that exceed the retailers’ cost of providing the transportation or delivery, the excess amount is subject to tax.

Mail order delivery charges are deemed to be agreed upon separately from the selling price of the tangible personal property being sold so long as the mail order form requires a separate charge for delivery and so long as the charges designated as transportation or delivery or shipping and handling are actually reflective of the costs of such shipping, transportation or delivery. See subsection (d) of Section 130.415. If the retailer charges a customer shipping and handling or delivery charges that exceed the retailer’s cost of providing the transportation or delivery, the excess amount is subject to tax.

If you pass along your incoming freight charges, you are not separately contracting with your customer for freight charges. Instead, you are passing your freight charges from your supplier on to your customer. Costs such as these are costs of doing business and are therefore included in your gross receipts subject to tax. See Section 130.415(e) and Section 130.410.

The sale of containers, as that term is defined in Section 130.2070(a), copy enclosed, is not subject to Retailers’ Occupation Tax when the purchasers of such containers transfer to customers the ownership of the containers together with what is contained in them. Therefore, in general, purchases of packing materials such as shrink-wrap are nontaxable as long as they are transferred along with the products contained in them to customers. Purchasers buying containers for this type of use are generally considered to be making tax-free purchases for resale purposes. Such purchasers must provide their suppliers with Certificates of Resale to document the exemption.

I hope this information is helpful. The Department of Revenue maintains a website, which can be accessed at www.revenue.state.il.us. If you have further questions related to the Illinois sales tax laws, please contact the Department's Taxpayer Information Division at (217) 782-3336.

If you are not under audit and you wish to obtain a binding Private Letter Ruling regarding your factual situation, please submit all of the information set out in items 1 through 8 of Section 1200.110(b).

Very truly yours,

Melanie A. Jarvis
Associate Counsel

MAJ:msk
Enc.